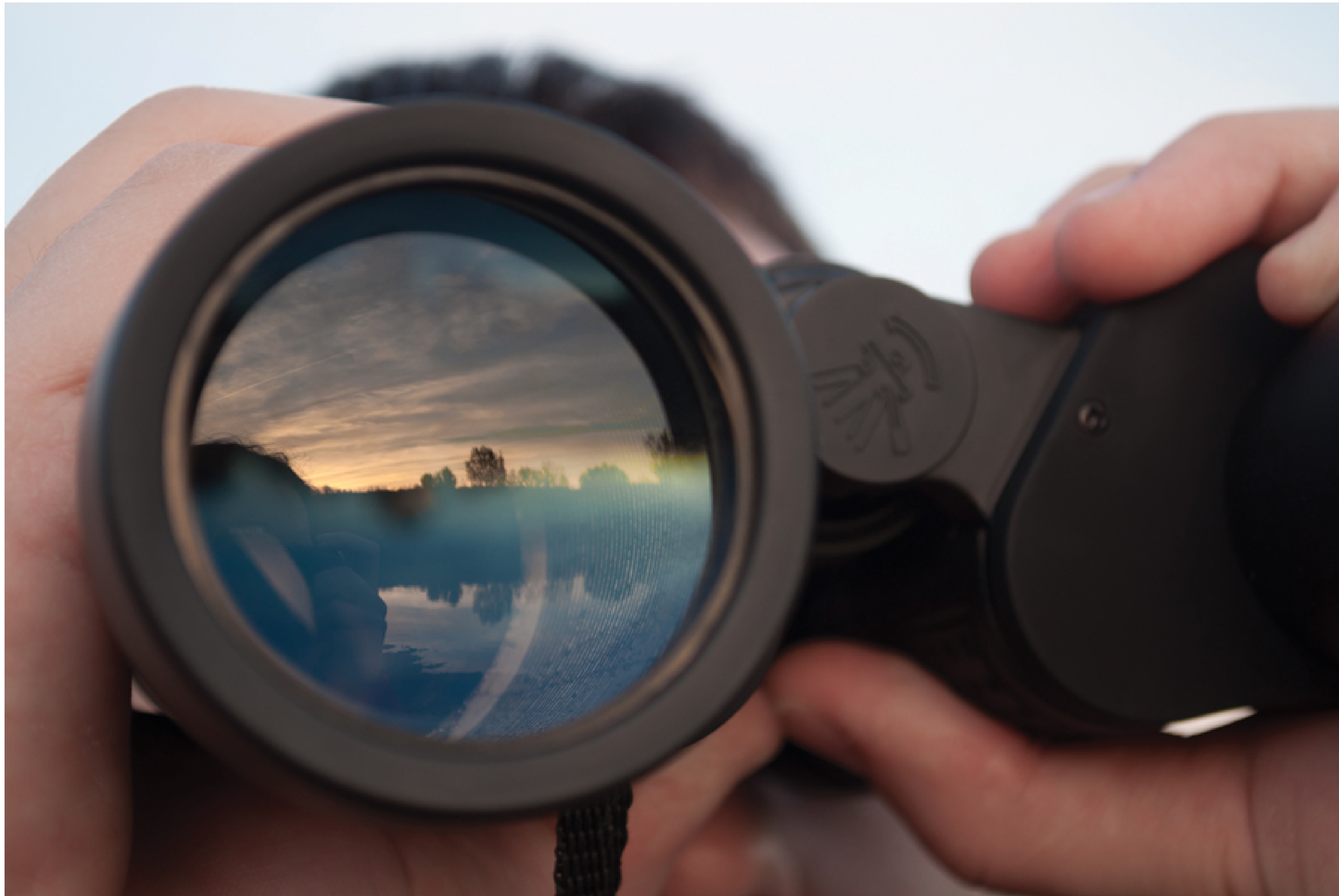
OPINION Investments

ETF market continues searching for the perfect expense ratio

When zero fees are not expensive enough



July 21, 2020 *By Jeff Benjamin*

You gotta hand it to the marketing wizards in the asset management industry for continuing their efforts to find the ***sweet spot when it comes to fund expense ratios***.

Oddly enough, free is not always the best price. And as upstart Salt Financial is learning, even paying investors to buy your ETF can be a deterrent.

Turns out, even though financial advisers as the largest buyer of ETFs place a ***premium on low fees***, there is a generally cautious notion that when something looks too good to be true, it probably is.

In the case of Salt Financial, the Salt Low truBeta US Market ETF (LSLT) was ***paying investors 5 basis points to own the fund*** for about a year beginning shortly after it launched in March 2019.

Yet, the fund was not able to attract even $9 million.

That fund has since hiked its expense ratio up to 29 basis points and, pending shareholder approval for an acquisition by Pacer Advisors, the fee is set to climb to 60 basis points.

Meanwhile, there's the ***dogged effort by Social Finance to entice investors*** with an extended zero-fee policy for SoFi Select 500 (SFY) and SoFi Next 500 (SFYX).

The two funds, which have been operating with waived fees since launching in April 2019 and have committed to zero fees through at least April 2021, have not produced the impact that analysts were expecting.

According to CFRA, SFY has grown to just over $98 million, but SFYX has yet to reach the $12 million mark.

"Without charging fees, the assets in those funds is lower than I would have expected after 16 months," said Todd Rosenbluth, director of mutual fund and ETF research at CFRA.

The only other examples of zero-fee ETFs were ***launched in April of this year by BNY Mellon***, which is approaching the teaser-rate strategy from a slightly different direction.

BNY Mellon US Large Cap Core Equity (BKLC) and BNY Mellon Core Bond (BKAG) represent a debut into the ETF space for a large, well-known asset manager that happens to be affiliated with a potential distribution source through its Pershing custodian.

In less than three months on the shelf, the bond ETF has grown to more than $30 million, which the equity ETF is closing in on $37 million.

The asset levels from an admittedly small sampling suggest that fees alone are not driving advisers toward certain ETFs.

"It's pure gimmick, and even if they have merit, there is already a deluge of ETFs, sliced and diced to stupidity levels," said Kashif Ahmed, president of American Private Wealth.

And for taxable accounts, sometimes zero fees don't make sense to move assets to a cheaper version, especially when there are so many ETFs with near-zero fees.

is only one characteristic among many in an investment consideration, and not worth obsessing over."

That point is driven home when you consider the relative success of JPMorgan BetaBuilders US Equity (BBUS), which was launched in March 2019 with a 2 basis point expense ratio and has grown to $161 million.

And that fund is not an anomaly. CFRA has identified more than three dozen ETFs across multiple investment categories that charge between 2 and 4 basis points.

The zero-fee game has not gained the same kind of traction in the mutual fund space but based on the success of the four funds launched by Fidelity in 2018, maybe the mutual fund industry should take heed.

Likely proving that brand names matter, the four Fidelity equity index funds combine for nearly $10 billion.

And with 'zero' in the fund names, it's a pretty safe bet that it's not just a teaser rate.

"The zero-expense ratio structure is permanent," confirmed a Fidelity spokesperson.

Meanwhile, in the ETF world, the market is sending a message that low fees alone can sometimes do more harm than good.

In essence, if you can't attract $100 million without fees, you might as well start charging a fee and take what you can get.